



25 years of growth

Philom Bios Highlights

- 100% revenue growth and 21% gross margin growth
- Earnings of \$0.59 million before extraordinary item (\$0.59 per share¹); the highest in Company history. Net earnings of \$0.7 million (\$0.21 per share¹)
- Philom Bios is the only company used by farmers in North America on over three million acres
- Paid \$0.50 per share to all shareholders in Company history
- Acquired a new state-of-the-art world class 105,000 square foot production, lab and distribution facility
- Invested over \$10 million in growth targeted projects including expansion of sales and marketing team and significant technology acquisitions
- Expanded sales and distribution position in markets served



Note 1: If all outstanding options were exercised, earnings per share amounts for earnings before extraordinary item and net earnings would be \$0.56 and \$0.20 per share respectively.

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letter to the shareholders

It began at a happenstance meeting at the Bessborough Hotel in late 1979. A casual conversation between three energetic minds, Dr. George Khachatourians, Mr. John Schaw, and myself, inevitably moved to the topic of agriculture. Our conversation evolved with increasing enthusiasm to the conclusion that microbial technologies were an untapped opportunity to help farmers improve crop productivity. The progress in translating that concept to reality is summarized in this Report.

Occasionally we should reflect on our historical success factors and this 25th Anniversary is such an occasion. A multidisciplinary staff has translated innovative microbial concepts into world-first products delivering performance reality in farmers' fields. The Philom Bios Board of Directors has been a constant force of effective oversight and we have benefited greatly from the synergies of research and business alliances and relationships with many supporters and partners. Alliances were initially driven by the simple expedient of multiplying limited resources, but in time, as we learned to design and nurture them these arrangements have become a strategic component of our business model.

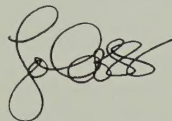
While impossible to identify all our supporters and collaborators here it is proper to recognize the National Research Council — both the Division of Biological Sciences, as it was known then, and the Plant Biotechnology Institute — all the Western Canada Research Stations of Agriculture

and Agri-Food Canada, and the Universities of the Prairie provinces, particularly the University of Saskatchewan.

Yet ultimately, the Company you read about in these pages exists because of the shareholders. Your patient confidence over the years is the reason Philom Bios is today the leader in its business sector delivering true value to an increasing number of farmers in our expanding marketplace.

On behalf of all the members of the Company I thank you for the trust you have placed in us - a trust we will continue to carry as we build the business in the years ahead.

Respectfully,



John Cross
Chairman



25 years of Growth

Over the past 25 years, production agriculture in much of the modern world has undergone a radical transformation. Farmers have adopted technology and production practices that have significantly increased the efficiency of food, feed and fiber production while leaving a much smaller environmental footprint. This has included the emergence of inoculants as a growing and relevant input category. The next 25 years will surely see change as profound as the last 25.

Philom Bios has now been a part of North American agriculture for 25 years and as our customers have evolved, so have we. As the agriculture environment continues to change over the next 25 years so will we to ensure we are well positioned to continue to serve the needs of our customers.

Growth in global food and feed demand will continue to drive demand for crop inputs in an environment of increasing fertility costs. We have and will continue to serve the needs of our customers by delivering inoculants that enhance the efficiency of their fertility investment.

Environmental and energy policy shifts continue to guide elements of our food production system in ways that further minimize its environmental footprint. We have and will continue to serve the needs of our customers by delivering inoculants that help provide crop fertility in an environmentally responsible manner and in a fashion that consumes less energy.

The pace of innovation that characterizes the inoculant industry continues to accelerate. We have and will continue to serve the needs of our customers by delivering on industry leading investments in key technology platforms targeted to meet our customers shifting challenges and opportunities.

Our track record of product and market development over the last 25 years is a harbinger of the next 25. The successes we see in our research and development program give us added enthusiasm.



the Last 25 Years

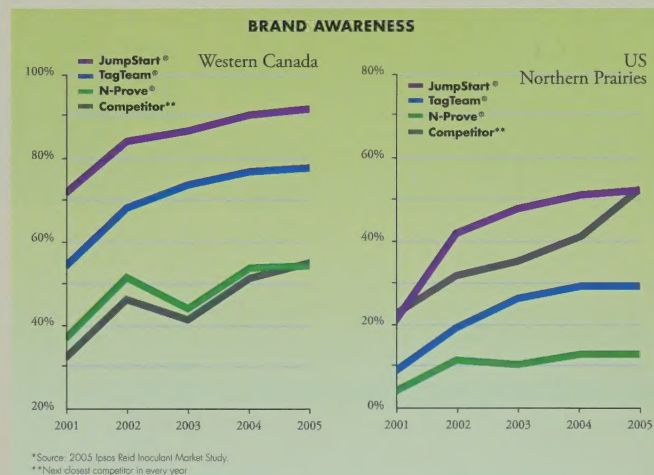
Philom Bios develops, manufactures and markets fertility efficiency tools that deliver a high net return on investment for agricultural producers in North America. We lead the marketplace in our category because our high value inoculants deliver a 3 to 1 net return on investment to our customers today. We deliver category leading value because of investments made in innovation over the last 25 years.

The naturally occurring soil fungus, *Penicillium bilaii*, provides the foundation for our past and current success. With this patent protected ingredient in proprietary products like JumpStart® and TagTeam®, we are the only company in the world that offers time-tested and proven phosphate efficiency inoculants. It is a key competitive advantage of our business.

Investments in the research of new products and the development of manufacturing and delivery processes for these products has generated a high return on investment for our shareholders. In 2005, an impressive 38% of our sales were generated from products or markets launched within the last three years.

Investments in communicating our brand promise to customers has led to awareness of our Philom Bios corporate brand that nearly doubles that of our competitors in our current markets. Our product brands JumpStart, TagTeam and N-Prove® also significantly lead competitors in product brand awareness.* Building our brands is a passionate pursuit for our

70 employees, many of whom are shareholders. That brand experience is now realized by farmers on over three million acres in North America.

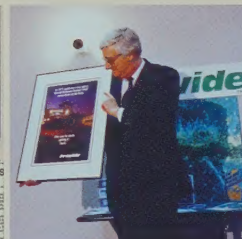


Clearly much has transpired to find us in our current position. From the Company's earliest beginnings in 1980 to today, Philom Bios has grown from a company of just two people in facilities measuring 400 square feet to a company of over 70 people in world-class production, office and lab facilities measuring 105,000 square feet.

OUR PURPOSE

SERVE THE NEEDS OF INDIVIDUAL CUSTOMERS BY DELIVERING HIGH VALUE INOCULANTS.

the Last 25 Years



1986

Penicillium bilaii licensed from Agriculture Canada

1991

PB-50 (JumpStart) launched – the world's first phosphate solubilizing inoculant

1996

Took ownership of customer relationships by building our own marketing team

2001

Expanded business into the United States

2005

- Launched JumpStart for corn and TagTeam for soybean in the United States
- Completed commercialization agreement with GRDC*
- Entered marketing partnership with SaskFerro
- Acquired and renovating a world-class 105,000 square foot facility

1989

N-Prove launched – the first high-quality, pre-sterilized, self-sticking peat inoculant in North America

1995

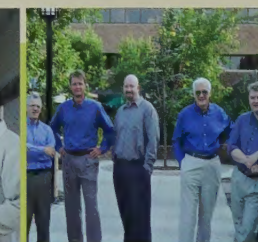
TagTeam launched – the world's first MultiAction inoculant

1997

Launched new high-performing Rhizobia strain in N-Prove and TagTeam

2004

Established a marketing partnership with AGROTAIN International



*GRDC is the Grain Research Development Corporation of Australia

the Next 25 Years

Given what we see in front of us in the coming 25 years, the investments we are making in creating leading competencies in three technology platforms: fertility efficiency, growth enhancement and root disease bio-control are paramount to our success.

Over the course of the next 24 months we plan to launch six new products and/or key label extensions targeted at delivering new value to pea, lentil, corn, and soybean producers in North America and beyond including the next generation of our *MultiAction™* TagTeam technologies for key pulse crops. In sum total, planned net 2006 investments in growth targeted projects will be just under \$1.5 million and are a key element of our plan to continue double digit top-line growth in the near term and significant profit growth in the medium term.

The Company's brand leadership will also continue to pay dividends for our partners and their complimentary technologies. The growth of the stabilized nitrogen category underpinned by AGROTAIN and the introduction of Nitrogain products that improve nitrogen fertilizer efficiency demonstrate how our brand reputation allows us to expand and serve more needs of more customers.

Our devotion to customer service and brand building sets us apart from other companies. From our office staff and field representatives who put a face to the Company, through to our research, manufacturing,

quality control and administrative groups who work hard to ensure that our premium products perform in the field, our employees are deeply committed to making the Philom Bios brand experience a positive and profitable encounter. Our main driver to growing our earnings is taking that brand experience to more and more customers. Progress on this front continues.

Expansion of key pulse acres in Western Canada to record levels and our continued market expansion into the United States is generating significant revenue growth for the Company and were key factors in the 19% growth in revenue in our 2005 results. We have made significant investments to expand our commercial infrastructure in North American corn and soybean markets. Significant and important steps have also been taken in other targeted markets beyond North America. These vital activities will further contribute to a better return on investment for our shareholders over the next 25 years.



Shareholder Returns

We are committed to creating tangible returns for our shareholders. Our initiatives in 2005 dealt effectively with cash reserves identified as in excess of that which could be effectively reinvested in growth. In March of 2005 the Board approved the first distribution to shareholders in Company history, enhancing return on equity for our shareholders. The financing of our new production, lab and office facilities provided an opportunity to increase our operational flexibility, expand capacity and lower operating costs.

We also made progress in creating a more transparent and liquid market for our stock, one in which the underlying value of our enterprise is beginning to be more fully recognized in our stock price. Committed to proactively telling our story, we will continue to inform investors about the Purpose of our Company and how it's creating value; not only for customers today, but for more and more customers tomorrow.

We are proud of the legacy of this Company over its first 25 years of serving the needs of our customers. We are tremendously excited about the steps we have taken to prepare for the next 25 years of our journey. And as we said last year, although nothing is risk-free, the course we have charted is coloured by a mindful path of prudent expansion and innovation that seeks to deliver on three commitments:

1. Deliver more value to the customers we have the privilege to serve today.
2. Invest prudently in technologies and growth markets that offer us the opportunity to serve new customers tomorrow.
3. Manage our internal operations with the rigor and discipline that translates the value we create for customers into lasting value for our shareholders. We exist to serve the needs of individual customers by delivering high value inoculants. By doing so we will create lasting value for our shareholders.



Management Discussion and Analysis

Management's Discussion and Analysis is intended to explain the Company's operating results and financial position for the 2005 fiscal year compared with those of previous fiscal years. Additionally, it provides the reader with an outlook on future trends and risks or other factors that may affect business operations with information available up to December 16, 2005. The following discussion and analysis should be read in conjunction with the consolidated financial statements and accompanying notes contained in this annual report. The Company's consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and have been reviewed by the Company's Audit Committee and approved by its Board of Directors. All amounts are in thousands of Canadian dollars unless indicated otherwise. Additional information on the Company is available on SEDAR at www.sedar.com.

DISCLOSURE CONTROLS AND PROCEDURES

As required by provincial securities legislation, the Company's Chief Executive Officer and Chief Financial Officer have evaluated the Company's disclosure controls and procedures for the Company's annual filings for the year ended September 30, 2005, and concluded that such disclosure controls and procedures effectively provide reasonable assurance that information required to be disclosed in the Company's annual filings is recorded, processed, summarized and reported within the time periods specified in the applicable Canadian securities legislation.

BUSINESS DESCRIPTION

Philom Bios Inc. is an agricultural crop input company with a 25 year history in the development, manufacture, and distribution of plant

inoculants and other fertility efficiency products. The Company's products comprise a range of proprietary and distributed inoculants and stabilized nitrogen products designed to provide our customers with enhanced fertility efficiency, increased yields, and improved profitability. The Company's products are sold through major agricultural distributors and retailers in Canada, the United States, and licensees in other countries.

The long-term success of the Company and strong market position clearly validate the effectiveness and value of our products in a challenging, and often uncertain, agricultural market. To ensure its continued advantage, in an increasingly competitive marketplace, the Company commits sizeable resources to research and business development. Operating under disciplined project management protocols that ensure full integration of development and commercialization activities, the Research and Business Development group maintains an active slate of development projects committed to delivery of new technologies or improvements on existing products.

As a 'reporting issuer' under provincial securities law, the Company is required to make continuous disclosure to the public of our annual and quarterly financial statements and any material changes in business or operations. Although not listed on any stock exchange, the shares of the Company are freely tradeable in an over-the-counter market with few restrictions, providing our shareholders and other investors the opportunity to participate in the benefits of equity ownership.

Key Performance Drivers

To deliver tangible shareholder value, management allocates resources to deliver on a balanced set of objectives of profitability, development,

INOCULANTS ARE NATURALLY OCCURRING MICRO-ORGANISMS DERIVED FROM THE SOIL THAT ARE APPLIED DIRECTLY TO THE SEED, OR IN FURROW, TO ENHANCE PLANT GROWTH BY ACCESSING IMPORTANT NUTRIENTS LIKE NITROGEN AND PHOSPHATE.

and market growth. Our success in achieving these goals is most typically evaluated by the following financial indicators:

- Revenue and Gross Margin Growth
- Net Earnings from Operations
- Return on Shareholders' Equity
- Debt to Equity Ratios

At an operational level the Company sets out annual departmental goals and objectives to ensure all departments contribute effectively to our stated business objectives. Additionally, the Company employs a disciplined project management process to evaluate the significant, and often long-term, investments in research and development projects. Finally, Management closely monitors wider industry metrics to measure our position in the industry.

Intellectual Assets

As a knowledge-based company, many of Philom Bios' greatest assets do not appear on the balance sheet. These assets include our proprietary know-how and intellectual property which include certain technology license agreements, corporate and product trade marks, product registrations, confidential disclosure agreements with corporate, academic and institutional bodies, and proprietary processes and manufacturing systems. These assets comprise a significant portion of the foundation of our present success and future potential. Our most powerful asset continues to be our people and customer relationships. We are industry leaders in providing widespread knowledge-based support for our distributors and retailers,

and our comprehensive customer database represents an important marketing advantage. Most importantly, our staff complement of 70+ employees, comprise a multidisciplinary array of scientific, technical, marketing, and business skills essential to build a dynamic enterprise. The blending of these skills into a customer-driven focus is our business model. Individual and collective commitment to the Purpose and the standards of the Company makes the business model work.

MAJOR ACHIEVEMENTS IN 2005

A summary of major achievements over the past year include:

- 19% revenue growth and 21% gross margin growth
- Earnings of \$2.0 million before extraordinary item (\$0.59 per share); the highest in Company history. Net earnings of \$0.7 million (\$0.21 per share)
- Philom Bios technologies used by farmers in North America on over three million acres
- First distribution to shareholders in Company history of \$0.50 per share
- Acquired and renovating a world-class 105,000 square foot production, lab and office facility
- Invested approximately \$1.5 million in growth targeted projects including expansion of North American sales team and significant technology acquisitions
- Leading market share and brand position in markets served

STABILIZED NITROGEN IS UREA-BASED FERTILIZER THAT HAS BEEN TREATED WITH A NITROGEN STABILIZER TO IMPROVE ITS EFFICIENCY AS A NITROGEN SOURCE BY REDUCING TYPICAL LOSSES THAT OCCUR WITHIN THE NITROGEN CYCLE.

Management Discussion and Analysis

CRITICAL ACCOUNTING ESTIMATES

Revenue Recognition

The Company recognizes revenue from the sale of goods when goods are shipped based on sale prices established by annual product offers set each fiscal year. Annual net sales are not completely determined until early order discounts are established at time of collection and inventory support payments are calculated.

Inventory Support

Consistent with industry practices, the Company offers inventory protection to its customers to ensure sufficient product is available in the distribution channels throughout the short selling season. As sales are

recorded, the Company makes provision for sales return charges based on historical results. These estimates are subject to significant adjustment once all customer reports are received and final return amounts are calculated following the end of the selling season.

CHANGE IN ACCOUNTING ESTIMATE

On the basis of an established trend of sustained and growing earnings, effective in 2005, the Company changed its accounting for investment tax credits. While in the past, all credits were recognized only as realized to reduce taxes otherwise payable, all tax credits are now recorded as earned and are accounted for as either a reduction in capital cost or as an expense recovery, depending on the nature of the expenditure. As a result of this change in estimate, in 2005 the Company recorded previously unrecognized investment tax credits of \$483 related to prior years.

RESULTS OF OPERATIONS

Overall Performance

Fiscal Year Ending (\$000's)	June 30 ²		September 30		
	2001	2002	2003	2004	2005
Sales	8,677	9,883	9,438	12,128	14,430
Gross Margin	6,638	6,452	6,003	7,712	9,326
Net Earnings before extraordinary item	1,571	1,208	53	1,413	2,046
Net Earnings	1,571	1,208	53	1,413	716
Earnings per share:					
Before extraordinary item	\$ 0.50	\$ 0.38	\$ 0.02	\$ 0.43	\$ 0.59
Net Earnings	\$ 0.50	\$ 0.38	\$ 0.02	\$ 0.43	\$ 0.21
Total Assets	10,230	7,529	7,811	9,141	13,486
Long-term debt, including current portion	226	331	242	120	2,905
Return on Equity ¹					
Net Earnings, before extraordinary item	41%	26%	1%	23%	30%
Net Earnings	41%	26%	1%	23%	10%

Note 1: Equity is defined as opening shareholder's equity adjusted for changes in share capital in the fiscal year on a weighted average basis.

Note 2: Company changed its year end on September 30, 2001.

Building on the momentum of a second consecutive year of double digit sales growth, the Company reported net earnings before extraordinary item for the year ended September 30, 2005 of \$2,046 representing \$0.59 per share as compared to earnings of \$1,413 or \$0.43 per share in the prior year. This year's outcome represents the highest operating earnings result in the Company's twenty-five year history. In offset, the Company recorded an extraordinary item of \$1,330 representing the cost of an adverse judgment, net of tax recovery, in regards to a legal claim by Dow AgroSciences as more fully described below.

Operating earnings gains can be attributed in large measure to the 19% increase in sales, with all product categories and markets growing over the prior year. These sales gains, together with improved gross margins and sound cost control led to our record operating results. The recording of prior years' investment tax credits not previously recognized have further contributed to improved earnings beyond guidance amounts provided in our third quarter news release.

On the strength of this success and a strong balance sheet, the Company delivered a return of capital to shareholders of \$0.50 per share in March 2005, the first in the Company's history. The Company's balance sheet was also significantly altered in the past year by the acquisition and subsequent renovation of a major manufacturing facility financed, in part, by a long-term mortgage. As at September 30, 2005, construction remains in progress with all improvements expected to be completed by the end of the 2005 calendar year.

Sales

Sales for the year ended September 30, 2004 amounted to \$14,430 as compared to the prior year of \$12,128 an overall increase of 19%. The

year over year change was achieved on sales increases across all product lines and market segments. On the strength of a solid distribution network and growing retail base, the TagTeam product suite accounted for the majority of the growth as our customers continue to affirm their support for our MultiAction technologies. Significant growth of our JumpStart business was also realized as this product continues to gain wider acceptance among producers of canola, corn and soybeans.

The Company's stabilized nitrogen products made major gains, nearly doubling, in what is developing into a major product class as farmers seek to protect their nitrogen fertilizer investment.

While our TagTeam and JumpStart product lines represent important market advantages, the Company continues to plan for changes. Future initiatives will seek to expand interest beyond our core pulse markets to serve a wider range of crops, especially soybean and corn with all product groups.

Cost of Sales and Gross Margin

Cost of sales for the year amounted to \$5,104 (2004 - \$ 4,416). Cost of sales includes the annual direct costs of production adjusted for changes in inventory, purchase cost of distributed products, royalties and freight and distribution costs. Total cost of sales increased because of higher sales volumes for all products, including the higher purchase costs of distributed products. However these increases were offset, in part, by production efficiencies that achieved improved unit volume output for manufactured products on stable overhead and material input costs, resulting in a total gross margin of 65%, a 1% improvement over the prior year.

Since most inoculants have only limited shelf life, earnings were negatively affected by inventory write-downs of unsold production and rejection of

Management Discussion and Analysis

product that did not meet our stringent quality standards. However, for 2005, write-downs were \$260 which compares very favorably with the past two years (2004 - \$442 and 2003 - \$500). This downward trend in product write-downs reflects the benefit of improved manufacturing procedures that better matches production and sales forecasts, despite our often challenging production and supply cycle.

Operating Costs

Total operating costs include all marketing and corporate expenses as well as research and development investments directed to development of new products, processes, and markets. Operating costs, before other expenses (income) amounted to \$6,460 (2004 - \$5,902) an increase of \$558 over the prior year. This increase reflects the increases in travel, marketing, recruiting, and salary and profit share amounts that are associated with our market expansion and research and development. The current year also includes significant legal fees incurred in defense of the DowAgroSciences claim. However, these costs have been partially offset by the recording of previously unrecognized investment tax credits of \$483 from prior years as mentioned above.

Extraordinary Item

As a result of the Court of Queen's Bench of Alberta judgment in favour of the 1997 claim by Dow AgroSciences Canada Inc. in respect of certain products which had passed their expiry, the Company has recorded an extraordinary item cost of \$1,330 representing damages, interest, and court costs, net of estimated tax recoveries of \$500. The Company has filed an appeal of this decision, and if successful, some or all of these amounts would be recoverable.

Research and Business Development

Research and Business Development expenditures continue to represent a significant portion of total spending as gross R&D spending, before any third party assistance and investment tax credits, increased a further 12% over the prior year. However, net R&D costs declined by \$244 primarily due to rising current year tax credits and the recording of the prior years' previously unrecognized tax credits.

Recognizing the need to innovate to respond to customer needs and opportunities, all R&D investments are principally focused on delivering key products that support our market expansion. Also, while R&D spending is rising in absolute terms, these costs continue to decline as a percentage of net sales, indicating the success of our past innovation spending. We remain confident of providing more and better outcomes on current development project investments.

Other expense (income)

Other expenses (income) includes net interest earnings, interest on long-term debt, operating costs of our new facilities during the period of construction, foreign exchange gains, and sundry income. Net interest earnings of \$83 (2004 - \$87) remained almost unchanged but were offset in the current year by long-term debt interest of \$32 related to the mortgage on the new building. Operating costs of \$208 for the Company's building reflect the period from December 2004 to July 2005, when the building was being renovated for use. Foreign currency gains in the year were \$13 (2003 - loss of \$28) and reflect the net effect of the changing value of the US dollar on our net cash flows. While the majority of sales and costs are incurred in Canadian funds, as sales in foreign markets continue to grow, the Company maintains close scrutiny of net cash flows to minimize our foreign currency exposure.

Income Taxes

Positive operating earnings resulted in a total tax expense in the current year of \$736 (2004 - \$469) which includes a future tax expense provision of \$280. The current tax expense of \$456 is offset by a tax recovery on the extraordinary item.

The Company's balance sheet now reflects an income tax credit recoverable of \$1,287, comprised primarily of federal and provincial investment tax credits available to reduce future income taxes. There is also an offsetting future tax liability of \$381 which arises due to accelerated capital cost allowance claims and the timing of the recognition of federal tax credits in taxable earnings.

QUARTERLY RESULTS ANALYSIS

The Company's sales are seasonal, with the majority of all sales realized during a very short period from late February to the end of May. In contrast, operating costs are generally incurred evenly over the year, with some fluctuation arising from certain seasonal activities related to field testing programs or sales and marketing initiatives. As a result, the Company generally records profitable earnings in only the 2nd and 3rd quarters of each fiscal year, although timing of customer purchases may vary, shifting earnings from one quarter to another. As a result, interim results are not necessary indicative of the results expected for the fiscal year. The Company's 4th quarter activities are dedicated to finalizing sales and customer support programs and preparing for the next year's production cycle.

Quarterly Results ('\$000's, except earnings per share)	September 30, 2004					September 30, 2005				
	D-03	M-04	J-04	S-04	TOTAL	D-04	M-05	J-05	S-05	TOTAL
Sales	\$ 6	\$ 5,278	\$ 6,911	\$ (67)	\$ 12,128	\$ —	\$ 6,820	\$ 7,435	\$ 175	\$ 14,430
Net earnings (loss) before extraordinary item	(1,333)	1,532	2,285	(1,071)	1,413	(1,262)	2,426	1,576	(694)	2,046
Net earnings (loss)	(1,333)	1,532	2,285	(1,071)	1,413	(1,262)	2,426	386	(834)	716
Basic earnings per share:										
Before extraordinary item	\$ (0.41)	\$ 0.47	\$ 0.70	\$ (0.33)	\$ 0.43	\$ (0.37)	\$ 0.70	\$ 0.45	\$ (0.19)	\$ 0.59
Net earnings (loss)	\$ (0.41)	\$ 0.47	\$ 0.70	\$ (0.33)	\$ 0.43	\$ (0.37)	\$ 0.70	\$ 0.11	\$ (0.23)	\$ 0.21

Management Discussion and Analysis

Most Recent Quarterly Results

The loss for the most recent quarter ending September 30, 2005, is fully consistent with the above noted business cycle and also reflects the benefit of strong fall sales, and the impact of final adjustments for investment tax credit accruals and income tax expenses.

ANALYSIS OF CASH FLOWS AND LIQUIDITY

Due to its business cycle, the Company is a net user of funds in the first and fourth quarter of each year since the majority of production and product acquisition costs are incurred early in the fiscal year while operating costs are generally incurred evenly over the year. In offset, the majority of revenues are collected either at the end of January, arising from certain early order/early pay incentives, or at end of June or early July. Due to strong cash reserves and marketing incentive programs, the Company did not require any short-term borrowing facilities throughout most of its fiscal year.

For the year ended September 30, 2005, the Company generated cash from operations, before changes in non-cash working capital of \$1,103 (2004-\$1,726). Net changes in non-cash working capital items increased this sum by \$835 reflecting the effect of certain timing differences associated with year over year changes in year end payables and the impact of future tax assets. Investment of capital includes additions to property, plant and equipment and patents of \$5,851 (2004 - \$316) with \$5,355 of this amount related to the building and construction in progress. The balance of equipment additions includes certain significant R&D assets and other upgrades and/or replacement of computer technology or manufacturing assets. Financing activities for the year reflect the two major events of the year, being the new mortgage

of \$2,880 and the return of capital payment of \$1,765 offset by \$182 of proceeds from issuance of common shares as certain options were exercised. The net effect of all cash flow changes resulted in an overall decrease in cash of \$2,712 and a year end cash and short-term investments balance of \$3,220.

FINANCIAL POSITION

The Company's year end balance sheet reflects several significant changes over the prior year. In particular, total assets increased significantly as the Company acquired a building for a purchase price of \$3,554, financed in part by a long-term mortgage. Additionally, the Company expended \$1,801 to September 30, 2005 on renovations to the production area, and development of the space for office and laboratory use. As noted earlier, at year end this construction is in progress and a further \$1,000 of costs will be incurred in the first quarter of the 2006 fiscal year to take this project to completion. The Company will draw on a further \$2,300 of long-term financing to support this major expenditure prior to the end of the calendar year. Other additions to plant and equipment, other than building and construction costs amounted to \$483 and were funded from current cash reserves.

Despite the interim affect of construction costs, the Company maintains a positive working capital balance of \$3,327 and working capital ratio of 1.90:1 (2004 - 5.6:1). This ratio will improve once other long-term financing is in place as noted above. Other than property, plant and equipment, the most significant year-end asset is cash and short-term investments of \$3,220 (2004 - \$5,932) which represents 24% of total assets and 48% of total shareholders' equity.

Total long-term debt, including the current portion now totals \$2,905 (2004 – \$120) as a result of the mortgage financing and certain capital leases. As noted above, the Company will draw on further long-term lending of \$2,300 once all building construction activities are complete. At year end the Company's total debt/equity ratios were 1.00:1 (2004 – 0.20:1).

Share capital also changed significantly in the year as a total of 113,802 shares were issued from treasury on the exercise of certain stock options for total proceeds of \$182 and the Company paid out a return of capital of \$1,765, representing \$0.50 per share.

RELATED PARTIES

Consistent with past years, the Company currently has significant transactions with certain related parties. These transactions are in the normal course of operations and are recorded at fair market values. For further information see Note 15 in the consolidated financial statements.

CAPITAL STRUCTURE

The Company's authorized share capital consists of an unlimited number of a single class of common shares issued without par value. As at the date of this report there are 3,529,563 share issued (2004 3,415,761). The following table shows a comparative summary of the transactions in the number of shares and the value of capital stock for 2005 and 2004.

Capital Stock and Share Transactions:

Number of shares outstanding	2005	2004
Beginning of year	3,415,761	3,230,141
Issued pursuant to exercise of options	113,802	185,620
End of year	<u>3,529,563</u>	<u>3,415,761</u>
Capital stock (\$000's)	2005	2004
Beginning of year	5,662	5,381
Proceeds on exercise of options	182	281
Return of capital distribution	(1,765)	-
End of year	<u>4,079</u>	<u>5,662</u>

Option Transactions

The Company has an Equity Compensation plan which provides for a grant of options to directors, management, and other employees. During the year, 81,300 new options were granted, 4,080 options expired, and 113,802 options were exercised. As a result of these transactions, as at the date of this report 174,940 options remain outstanding, and now represent 5% of issued shares (2004-6%). A list of outstanding share options, providing a break-down between directors and employees/officers can be found in Note 9 to the financial statements.

Fair Value of Options

Current accounting standards of the Canadian Institute of Chartered Accountants require public companies to determine the fair value of all stock options granted in a particular year. Management has determined that due to

Management Discussion and Analysis

the limited trading volumes and history for our Company's stock which only trades on an 'over the counter' market, it is not possible to arrive at a supportable estimate of the Company's stock price and volatility as required by the Black-Scholes option pricing model. Accordingly, the Company has not recorded any charge to net earnings for stock options granted in the year.

OUTLOOK AND PERFORMANCE RISKS

Growing global food demand and its resultant demands on crop production coupled with rising energy and other costs that dramatically affect farmer input costs, all indicate tremendous potential for continuing and increasing need for enhanced farm productivity tools. Additionally, we are increasingly aware of a quickening pace of innovation amongst our competitors, indicating their concurrence with our assessment of the potential global market for inoculants.

The 2006 outlook for our North American markets point to growth as awareness and use of inoculants or other crop fertility products drives farmers to seek the very best productivity enhancements. Our current products deliver on this promise. The Company is well positioned to continue top-line growth.

All major product groups are targeted to contribute to sales increases in 2006 with distributed product growth expected to play a major part in sales growth. In particular, building on the significant growth of Stabilized Nitrogen in 2005 driven by increasing recognition of the productivity improvement AGROTAIN and Nitrogain deliver to farm customers, this category is expected to contribute significantly to our sales growth in 2006.

For the next several years, North American pulse markets are expected to remain a significant revenue stream that supports our earnings. The strength of our Core markets has allowed us to springboard into a wider geographic area. The Company continues to build on its strategy of expanding our business in North American corn and soybean markets and developing and implementing plans for other parts of the world. Our rapid and successful advance into the North American corn and soybean market gives us additional confidence in our business model.

With a balanced plan to deliver superior annual return on equity, complete major research and development projects, and a clear plan to enter new markets we are anxious to reward shareholders with sustainable growth and significant payback on their invested capital. In sum total, planned net 2006 investments in growth targeted projects will be just under \$1.5 million and are a key element of our plan to continue double digit top-line growth in the near term and significant profit growth in the medium term. While no business can foresee or plan for every variance that may occur, we remain confident that we have chosen to build our strategy on a sound and balanced path to deliver shareholder value for years to come.

In serving an agricultural market, the Company faces a complex range of market and environment risks, many over which we have little control. A summary of certain of our more significant risks include:

- **Environmental Conditions:** Dramatic year to year changes in weather and growing conditions in our markets impact producer decisions that may lead to a reduction in the use of inoculant products and other inputs.
- **Competition:** The Company faces the ongoing risks that are typical of any competitive marketplace. These risks include pricing, competitive innovations, and control of supply or distribution channels.

- **Regulatory and political framework:** All of our products are subject to environmental and regulatory restrictions imposed by Federal, provincial and state governments. In Canada, all products must meet stringent test, performance, and labeling conditions as approved by the Canadian Food Inspection Agency (CFIA). For the U.S. market, products are generally regulated at the state level. While U.S. regulations are generally perceived as less onerous, all government agencies have the authority to potentially delay approvals or withdraw our inoculant products from the market place.
- **Other Factors:** The Company must also manage various internal risk factors, including production supply and quality issues, credit risks, foreign currencies, and property liability exposure. These risks are mitigated by sound internal control processes and policies overseen by management.

FORWARD LOOKING STATEMENTS

This Annual Report to the Shareholders contains forward looking statements, particularly in the outlook update above, which involve risks and uncertainties. A number of factors could cause actual results to differ materially from those in the forward-looking statements, including, but not limited to, economic and growing conditions in North American agriculture; changes in competitive pressures including pricing pressures; government policy changes particularly with respect to regulatory approvals; changes in capital markets and the consequent effect on working capital supply; unforeseen barriers in new process and product systems; changes in shareholders or the capital structure of the Company; and changes in currency and exchange rates.

Securities laws require the Company to update these forward looking statements as needed to prevent them from being rendered untrue by subsequent events. The Company does this in each quarter's Management Discussion & Analysis and also issues press releases from time to time as material events occur, which may related to the forward looking statements in our outlook update. Shareholder and other interested persons are cautioned to monitor the Company's filings at www.sedar.com and/or to add their name to our supplemental mailing list in order to receive these documents directly, by e-mail, fax, or direct mail. The Company does not undertake any other or further obligation to publicly update or revise and forward-looking statements.



Governance Statement

The Board of Directors has responsibility for the stewardship of the Company as set out in the Company's Board Charter and Corporate Governance Guidelines. The primary responsibilities of the Board are to establish the overall policies and standards of operation, review and approve the strategic plans and annual budget, establish the goals and objectives of the President/CEO and to assess the performance of the President/CEO and the Company's progress against annual plans.

The Board also maintains awareness of the principal risks to the Company and the strategies management uses to mitigate these risks; has reasonable assurance of the integrity of internal controls and management information systems; has determined that the Company meets or exceeds all applicable environmental laws and regulations; approves the audited financial statements and documents for shareholder meetings; and has established an appropriate code of Business Conduct and Ethics Practice and communications policy.

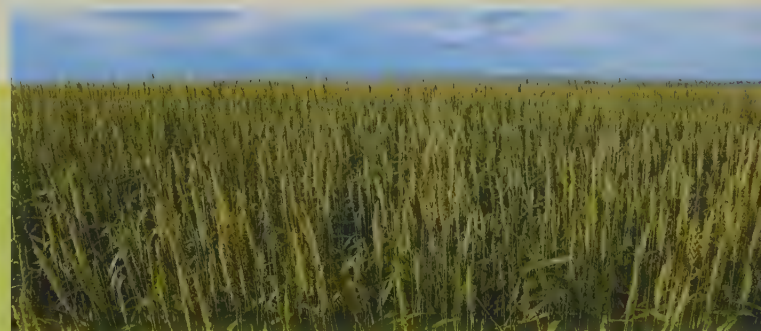
As at September 30, 2005, all directors are non-management. Two directors previously served as members of senior management.

The Board has three Standing Committees: Audit, Governance, and Compensation, each with a charter which is reviewed regularly. The Board also establishes special purpose committees to perform specific duties as the need may arise from time to time.

The mandate of the Governance Committee includes responsibility for the nomination, orientation and succession planning of Board members, establishing a program of continuing education for all Board Members and monitoring the performance of the Board, its members and its committees.

The mandate of the Audit Committee includes responsibility for the relationship with the external auditor, the external financial reporting of the corporation, and overseeing the financial and legal risks of the corporation, and management's mitigation processes for these risks, and the appropriateness of internal controls.

The mandate of the Compensation Committee includes an annual review of the performance of the President/CEO, and making recommendations to the Board on compensation of all executives, reviewing the processes for evaluation and compensation of executives, and reviewing and recommending any employee incentive plans of the Company.



Financial Statements

Report

The management of Philom Bios Inc. is responsible for the preparation of the financial statements and related financial information included in this Annual Report. The financial statements have been prepared in conformity with Canadian generally accepted accounting principles, and necessarily include amounts based on management's informed judgments and estimates.

A system of internal disclosure and accounting controls and management practices have been developed, and are maintained to provide reasonable assurance that the financial statements are reliable, and that assets are safeguarded.

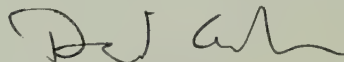
The Company's financial statements have been audited by Deloitte & Touche who were appointed by the shareholders. Their report for 2005 is included.

The Audit Committee of the Board of Directors, which is composed exclusively of outside directors, meets as necessary to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues. The Audit Committee meets with the auditors as it considers necessary.

These financial statements have been approved by the Board of Directors on the recommendation of the Audit Committee.



President / CEO



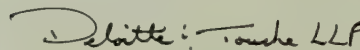
Chief Financial Officer

TO THE SHAREHOLDERS OF PHILOM BIOS INC.

We have audited the consolidated balance sheet of Philom Bios Inc. as at September 30, 2005 and the consolidated statements of earnings and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at September 30, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants
November 10, 2005

**CONSOLIDATED STATEMENT OF EARNINGS AND RETAINED EARNINGS
FOR THE YEAR ENDED SEPTEMBER 30, 2005**

IN THOUSANDS OF DOLLARS EXCEPT SHARE AND PER-SHARE AMOUNTS

	2005	2004
Sales	\$ 14,430	\$ 12,128
Cost of Sales	5,104	4,416
Gross Margin	9,326	7,712
Expenses		
Research and development (NOTE 10)	1,352	1,596
Marketing and sales	3,147	2,662
General and administrative	1,961	1,644
Other expenses (income) (NOTE 11)	84	(72)
	6,544	5,830
Earnings before Income Taxes and Extraordinary Item	2,782	1,882
Income Taxes before Extraordinary Item		
Current expense	(456)	(469)
Future expense	(280)	-
	(736)	(469)
Net Earnings before Extraordinary Item	2,046	1,413
Extraordinary Item (Net of tax recovery of \$500) (NOTE 13)	(1,330)	-
Net Earnings	716	1,413
Retained Earnings, Beginning of Year	1,958	545
Retained Earnings, End of Year	\$ 2,674	\$ 1,958
Basic net earnings per share: (NOTE 9)		
Before extraordinary item	\$ 0.59	\$ 0.43
Extraordinary item	(0.38)	-
Net earnings	\$ 0.21	\$ 0.43

CONSOLIDATED BALANCE SHEET
AS AT SEPTEMBER 30, 2005

IN THOUSANDS OF DOLLARS EXCEPT SHARE AND PER-SHARE AMOUNTS

	2005	2004
Current Assets		
Cash and short-term deposits	\$ 3,220	\$ 5,932
Accounts receivable	407	253
Inventories (NOTE 4)	1,981	1,796
Prepays and deposits	113	147
Income tax credit recoverable (NOTE 12)	1,287	-
	<u>7,008</u>	<u>8,128</u>
Property, Plant and Equipment (NOTE 5)	6,351	894
Other Assets (NOTE 6)	127	119
	<u>\$ 13,486</u>	<u>\$ 9,141</u>
Current Liabilities		
Accounts payable and accrued charges	\$ 3,447	\$ 1,292
Deferred development assistance (NOTE 7)	-	109
Current portion of long term debt (NOTE 8)	234	64
	<u>3,681</u>	<u>1,465</u>
Future Tax Liability (NOTE 12)	381	-
Long Term Debt (NOTE 8)	<u>2,671</u>	<u>56</u>
	6,733	1,521
Shareholders' Equity		
Share capital (Note 9)		
Authorized:		
Unlimited number of common shares		
Issued:		
3,529,563 common shares		
(2004 - 3,415,761)	4,079	5,662
Retained earnings	<u>2,674</u>	<u>1,958</u>
	6,753	7,620
Approved by the Board	<u>\$ 13,486</u>	<u>\$ 9,141</u>



Director



Director

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED SEPTEMBER 30, 2005

IN THOUSANDS OF DOLLARS EXCEPT SHARE AND PER-SHARE AMOUNTS

Cash Flows from (used in) the Following Activities

Operating

Net earnings	\$	716	\$	1,413
Adjustment for amortization		387		313
		1,103		1,726

Changes in non-cash working capital

Accounts receivable	(154)	(109)
Income tax credit recoverable	1,287	-
Inventories	(185)	(205)
Prepays and deposits	34	(59)
Future income tax liability	381	-
Accounts payable and accrued charges	2,155	(176)
Deferred development assistance	(109)	(65)
	1,938	1,112

Investing

Additions to property, plant and equipment	(5,838)	(302)
Additions of other assets	(13)	(14)
	(5,851)	(316)

Financing

Proceeds from long term debt	2,880	-
Repayment of long term debt	(96)	(122)
Return of capital	(1,765)	-
Proceeds from issuance of common shares	182	281
	1,201	159

Net (Decrease) Increase in Cash

(2,712) 955

Cash Position, Beginning of Year

5,932 4,977

Cash Position, End of Year

\$ 3,220 \$ 5,932

Supplemental Disclosure of Cash Flows Information

Interest paid	\$	44	\$	13
Income taxes paid		1		-

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED SEPTEMBER 30, 2005**

IN THOUSANDS OF DOLLARS EXCEPT SHARE AND PER-SHARE AMOUNTS

1. DESCRIPTION OF BUSINESS

Philom Bios Inc. ("the Company") is incorporated under The Business Corporations Act (Saskatchewan). The Company researches, develops, manufactures and sells microbial inoculants to serve the needs of farmers.

These statements are presented on a consolidated basis. The Company's wholly owned US subsidiary is accounted for using the temporal method. Under this method, monetary assets and liabilities are translated at the exchange rates in effect at the balance sheet dates. Non-monetary assets and liabilities are translated at historical rates. Revenues and expenses are translated at average rates for the period. Translation exchange gains or losses are reflected in net earnings. Intercompany balances and transactions have been eliminated.

2. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and reflect the following policies:

Inventories

Inventories of raw materials, work-in-process and finished goods are valued at the lower of cost and net realizable value. Cost of inventory is determined using the specific item method.

Property, Plant and Equipment

All asset classes are stated at cost and are amortized using the declining-balance method.

Intangible Assets

Intangible assets are comprised of patents, trademarks and licenses and are stated at cost. Patents are amortized using the straight-line method over seven years from the commencement of commercial production of the

related products. Trademarks are amortized using the straight-line method over forty years. Licenses are amortized using the straight-line method over ten years.

Income Taxes

The Company uses the liability method of accounting for income taxes. Accordingly, future tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of existing assets and liabilities, and are measured using the substantially enacted tax rates and laws that are expected to be in effect when the differences are expected to be recovered or settled.

Research and Development

The Company expenses research and development costs as incurred.

Leases

Leases entered into by the Company as lessee that transfer substantially all the benefits and risks of ownership to the lessee are recorded as capital leases and included in fixed assets and long-term debt. All other leases are classified as operating leases under which leasing costs are recorded as expenses in the period in which they are incurred.

Revenue Recognition

The Company recognizes revenue from the sale of goods when the goods have been shipped. Deferred development assistance is taken into income in the period in which the related expenses have been incurred.

Use of Estimates

The preparation of the consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the year. Actual results could differ from those estimates.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED SEPTEMBER 30, 2005**

IN THOUSANDS OF DOLLARS EXCEPT SHARE AND PER-SHARE AMOUNTS

2. SIGNIFICANT ACCOUNTING POLICIES continued

Stock Options

The Company makes an annual grant of stock options pursuant to certain equity compensation plans in place for officers, employees and directors. As provided for by the accounting recommendations of the Canadian Institute of Chartered Accountants, the Company is required to disclose the fair value of stock options granted in the year on net earnings (see Note 9).

The fair value of stock options is determined by reference to the Black-Scholes option pricing model. This model requires the input of a number of assumptions, including dividend yield, expected stock price volatility, expected time until exercise, and risk free interest rate. Certain of these assumptions involve inherent uncertainties based on market conditions generally outside of the control of the Company.

3. FINANCIAL INSTRUMENTS

A portion of the Company's revenues and expenditures are denominated in US dollars. The Company is exposed to currency fluctuations on transactions denominated in US dollars and the potential currency fluctuations may impact on the profitability of the Company. This risk is managed, from time to time, through the use of foreign exchange forward contracts to fix the exchange rates on future net foreign currency cash flows. The Company does not hold or issue derivative contracts for speculative or trading purposes.

As at September 30, 2005 and 2004, the Company has no foreign currency forward contracts.

The carrying values of cash and short-term deposits, accounts receivable, accounts payable, accrued liabilities and long term debt approximate their respective fair values.

4. INVENTORIES

	2005	2004
Raw materials and work-in-progress	\$ 1,671	\$ 1,588
Finished goods	310	208
	\$ 1,981	\$ 1,796

5. PROPERTY PLANT AND EQUIPMENT

	Rates	Cost	Accumulated Amortization	Net Book Value	
				2005	2004
Land		\$ 503	\$ -	\$ 503	\$ -
Paving	8%	267	17	250	-
Building & construction in progress	4%	4,585	72	4,513	-
Furniture & fixtures	20%	117	73	44	56
Computer & lab equipment	20-50%	1,547	730	817	476
Automotive equipment	30%	30	26	4	5
Production equipment	25-30%	1,238	1,018	220	357
		\$ 8,287	\$ 1,936	\$ 6,351	\$ 894

The above includes equipment under capital leases with a cost of \$319 (2004 - \$319) and accumulated amortization of \$248 (2004 - \$218).

The building cost includes \$1,801 of construction in progress. As a result no amortization has been charged against this portion of the asset to date.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED SEPTEMBER 30, 2005**

IN THOUSANDS OF DOLLARS EXCEPT SHARE AND PER-SHARE AMOUNTS

5. PROPERTY PLANT AND EQUIPMENT continued

Amortization of \$382 has been expensed during the year (2004 - \$308). This includes \$30 (2004 - \$46) of amortization relating to equipment under capital leases.

Certain capital acquisitions are eligible for investment tax credits and accordingly the cost bases of these assets have been reduced by the amount of the credits. The reductions to cost bases in the current year total \$410 (2004- \$102).

6. INTANGIBLE ASSETS

	Cost	Accumulated Amortization	Net Book Value	
			2005	2004
Patents	\$ 100	\$ 67	\$ 33	\$ 22
Trademarks	106	22	84	84
Licenses	14	4	10	13
	\$ 220	\$ 93	\$ 127	\$ 119

Additions to intangibles totaled \$13 for the year (2004 - \$14).
Amortization of \$5 has been expensed during the year (2004 - \$5).

7. DEFERRED DEVELOPMENT ASSISTANCE

In prior years the Company has received \$318 from unrelated companies as a contribution towards research and development projects. At year end, \$Nil (2004 - \$109) remains deferred.

8. LONG TERM DEBT

The long term debt obligations of the Company are as follows:

	2005	2004
Mortgage payable	\$ 2,849	\$ -
Capital lease obligations	<u>56</u>	<u>120</u>
	\$ 2,905	\$ 120
Less: current portion	<u>(234)</u>	<u>(64)</u>
	\$ 2,671	\$ 56

The mortgage is secured by a first charge on the land, paving and building assets and certain other undertakings. Interest paid on this obligation during the year totaled \$32 and is calculated at a variable rate based on bankers' acceptance rates plus a 1.75% stamping fee. The mortgage principal is payable in equal monthly payments of \$16 over 15 years.

The principal payments on the mortgage are scheduled as follows:

2006	\$ 192
2007	192
2008	192
2009	192
2010	192
Subsequent years	1,889

The interest rates on the capital lease obligation is 6.69% maturing in 2007. During the year the Company paid interest relating to capital leases of \$6 (2004 - \$12).

The minimum lease payments over the next two years by the Company are as follows:

2006	\$ 42
2007	<u>14</u>
	\$ 56

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED SEPTEMBER 30, 2005**

IN THOUSANDS OF DOLLARS EXCEPT SHARE AND PER-SHARE AMOUNTS

9. SHARE CAPITAL

a) Stock Options

The Company's stock options are granted pursuant to equity compensation plans in place for officers, employees and directors. All options granted must be approved by the Board and vest concurrently with the grant date. Since the Company's shares trade only in an over the counter market, Management has determined that due to restricted market visibility and limited trading volumes and history, it is not possible to arrive at a supportable estimate of the Company's stock price and volatility using the Black-Scholes option pricing model. Accordingly, the effect of applying the fair value method of accounting for the 81,300 stock options granted during the year on earnings is not determinable.

A summary of all option transactions and year end options outstanding as at 2005 and 2004 is as follows;

During the year, officers and employees of the Company exercised 101,802 options at \$1.50 (2004-170,540 at \$1.50 and 1,080 at \$4.00) for total cash consideration of \$153 (2004 - \$260). During the year, Directors exercised 8,000 options at \$1.50 and 4,000 options at \$4.00 (2004-14,000 at \$1.50) for total cash consideration of \$28 (2004 - \$21).

At September 30, 2005, employee/officer options outstanding consist of 111,800 options exercisable at \$4.00 and 140 options exercisable at \$1.50 and Director options outstanding consist of 57,000 options exercisable at \$4.00 and 6,000 options exercisable at \$1.50. If not exercised, all outstanding options expire between August 31, 2006 and February 13, 2010.

	Number of Options – not in thousands			
	Employee /Officer	Director	Totals 2005	2004
Balance, beginning of year	157,522	54,000	211,522	357,462
Transactions during the year:				
Options granted	65,300	16,000	81,300	44,000
Transferred between plans	(5,000)	5,000	-	-
Options cancelled	(4,080)	-	(4,080)	(4,320)
Options exercised	(101,802)	(12,000)	(113,802)	(185,620)
Balance, end of year	111,940	63,000	174,940	211,522

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED SEPTEMBER 30, 2005**

IN THOUSANDS OF DOLLARS EXCEPT SHARE AND PER-SHARE AMOUNTS

9. SHARE CAPITAL *continued*

b) Earnings Per Share

Earnings per share is calculated based on the weighted average number of shares outstanding during the period, which was 3,488,550 (2004 - 3,283,540). A calculation of diluted earnings per share has not been shown since the treasury stock method requires the use of stock prices which are not available, as discussed above.

10. RESEARCH AND DEVELOPMENT

	2005	2004
Direct research and development	\$ 2,368	\$ 2,122
Research and development assistance	(139)	(159)
Benefit from investment tax credits	(877)	(367)
Research and development	<u>\$ 1,352</u>	<u>\$ 1,596</u>

Research and development assistance includes amounts described in Note 7 in addition to government grants of \$30 (2004 - \$94) which carry no terms and conditions and are not repayable.

The Company has determined that there is reasonable assurance that all investment tax credits will be realized prior to their expiry. Accordingly all credits, including \$483 of previously unrecognized credits have been accrued in the current year.

11. OTHER EXPENSES (INCOME)

	2005	2004
Interest expense on long term debt	\$ 32	\$ -
Interest income - net	(83)	(87)
Operating costs of building under construction	208	-
Foreign exchange (gain) loss	(13)	28
Other	(60)	(13)
	<u>\$ 84</u>	<u>\$ (72)</u>

12. INCOME TAXES

Accumulated research and development expenditures of \$1,146 (2004 - \$631) were used to reduce current taxable income. Federal and provincial income tax credits of \$Nil (2004 - \$469) were used to reduce income tax payable. Income tax credits recoverable which are available to reduce future income taxes payable are summarized in the following table. These credits begin to expire in 2010.

	Operating Expenses	Capital Expenditures	Total
Investment Tax credits:			
Earned in 2005	\$ 394	\$ 342	\$ 736
Earned in prior years	483	-	483
	<u>877</u>	<u>372</u>	<u>1,219</u>
Manufacturing and processing credits:			
Earned in 2005	-	68	68
	<u>\$ 877</u>	<u>\$ 410</u>	<u>\$ 1,287</u>

Future income tax liabilities (assets) include differences in the amortization methods of property, plant and equipment and intangibles which give rise to future income tax liabilities.

The future income tax liabilities (assets) are as follows:

	2005	2004
Property, Plant and Equipment	\$ 314	\$ -
Federal investment tax credit earned	125	-
Benefit from loss carry forward	(58)	-
	<u>\$ 381</u>	<u>\$ -</u>

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED SEPTEMBER 30, 2005**

IN THOUSANDS OF DOLLARS EXCEPT SHARE AND PER-SHARE AMOUNTS

13. EXTRAORDINARY ITEM

As a result of a Court of Queen's Bench of Alberta judgment rendered in favor of Dow AgroSciences Canada Inc. stemming from a 1997 legal dispute related to certain Company products which had passed their expiry date, the Company has accrued an extraordinary item cost of \$1,330 representing damages, interest, and estimated court costs of \$1,830, net of estimated tax recoveries of \$500. The Company has filed an appeal of this decision. All known and estimated liabilities in this matter have been recorded as a charge against current earnings, but are expected to be fully recoverable in the event of a successful appeal of this matter.

14. GEOGRAPHIC INFORMATION

Sales to foreign countries, primarily the United States, comprise approximately 15% of total sales. The Company has no material capital assets or goodwill attributable to any foreign country.

15. RELATED PARTY TRANSACTIONS

During the year, the Company entered into the following related party transactions:

- (i) purchase of consulting services for \$63 (2004 – \$28) from a Director and a company wholly owned by a Director
- (ii) purchase of product in the amount of \$626 (2004 – \$297) from a company controlled by a Director
- (iii) rental of warehousing and manufacturing space for \$108 (2004 – \$138) from a company partially owned by a Director

These transactions are in the normal course of operations and are measured at the exchange amount, which represents market value.

16. COMMITMENTS

The future minimum lease payments under operating leases for the Company are as follows:

2006	\$ 138
2007	29
	<u>\$ 167</u>

The Company has committed \$20 per year for the next two years to an unrelated association for program sponsorship.

The Company has committed \$1,230 to an unrelated company for services to be rendered between April 1, 2005 and March 31, 2008.

The Company has committed to purchase approximately \$1,000 of products and services related to construction improvements to the building asset.

The Company has committed to purchase a minimum of \$547 USD of product for resale prior to September 16, 2006 from a related party at a market price.

Philom Bios Board of Directors 2005

JOHN BECHERER - DIRECTOR

John Becherer is the Chief Executive Officer of the United Soybean Board, a St. Louis, Missouri based organization that invests in research and marketing activities for US soybeans and soy products. Mr. Becherer joined the Philom Bios Board in June, 2005.

GARTH BELL, DIRECTOR

A Director since 2000, Mr. Bell is General Manager of Spruce View Co-operative, in Spruce View, Alberta. Previously, Mr. Bell held progressively senior positions with Saskatchewan Wheat Pool from 1976 to 2000, completing his tenure as General Manager, Agri-Products Group.

BEVERLEY BRENNAN, DIRECTOR

Beverley Brennan, F.C.A., joined the Company in 1987, held the office of Vice President Finance from 1988 to 2000, and served as Corporate Secretary from 1990 to November 2003. Appointed to the Philom Bios Board in 1998, Ms. Brennan has held executive positions in the Canadian Institute of Chartered Accountants, including Chair in 1998/99, and is currently a Director of several Canadian companies and institutes.

WAYNE BROWNLEE, DIRECTOR

Wayne Brownlee has been a Director of Philom Bios since 1992. Mr. Brownlee is Senior Vice President, and CFO, Potash Corporation of Saskatchewan. PCS is the world's largest producer of crop nutrients and a leading global supplier of N.P.K. for animal feed and industrial uses.

JOHN CROSS, CHAIRMAN

A founding partner of the Company in 1980, Mr. Cross brings 40 years of research and business development experience in the food, agriculture, and biology industries to the Board table.

GEORGE KHACHATOURIANS, DIRECTOR

Dr. Khachatourians is the President of Khachatourians Enterprises Inc., a biotechnology firm, and was a co-founder of Philom Bios in 1980. An internationally recognized and prolific biological scientist, he has been a Professor of Microbiology in the Colleges of Medicine and Agriculture, University of Saskatchewan since 1974. He is the founder and coordinator of Center for Molecular Agriculture and Applied Biotechnology, and is currently Head, Department of Applied Microbiology and Food Science, College of Agriculture.

ROD MERRYWEATHER, DIRECTOR

Director of Sales, Canada, Bayer CropScience Inc. in Calgary, Mr. Merryweather has over 25 years of operational and senior management experience in the crop protection sector of Canadian agriculture. Mr. Merryweather joined the Board in 2003.

RICHARD STEGMANN, DIRECTOR

Chairman of Lange-Stegmann Co., a Missouri-based wholesaler of agricultural, professional and industrial fertilizers, Mr. Stegmann has been a Director since 1998. Founded in 1926, Lange-Stegmann is a leading distributor of fertility products throughout the US Central States.

RODNEY WIENS, DIRECTOR

A prominent farmer in the Herschel district West of Saskatoon, Mr. Wiens has been active in Saskatchewan Wheat Pool member affairs for many years and was a Director of Saskatchewan Wheat Pool from 1997 to 2001. Mr. Wiens joined the Philom Bios Board in 1997.

GREGORY YUEL, DIRECTOR

Gregory Yuel is the Vice President and COO of PIC Investment Group Inc., a privately owned investment holding company with interests in a diverse group of related companies in the chemical, petroleum, transportation, packaging and property management industries. Mr. Yuel joined the Philom Bios Board in 2002.

Notice of Meeting

The Annual General Meeting of Shareholders will be held on Tuesday, February 14, 2006 at the Company's Head Office, 3935 Thatcher Ave., Saskatoon, Saskatchewan at 11:30 a.m. (Central Standard Time). The Financial Statements for the 12 month period ending September 30, 2005 will be presented and management will review corporate developments to date. All shareholders are encouraged to attend, but if unable to do so, all shareholders are requested to complete, sign and return to the Company the provided form of proxy.

Corporate Information

BOARD OF DIRECTORS

John Cross ^{2/3}
Chairman
Philom Bios Inc.
Saskatoon, Saskatchewan

John Becherer
CEO, United Soybean Board
St. Louis, Missouri, USA
(from June 1, 2005)

Garth Bell ²
General Manager
Spruce View Co-operative Association
Spruce View, Alberta

Beverly Brennan ^{1/3}
Director
Edmonton, Alberta

Wayne Brownlee ^{1/2}
Senior Vice President
Chief Financial Officer
Potash Corporation of Saskatchewan Inc.
Saskatoon, Saskatchewan

George Khachatourians ³
President
Khachatourians Enterprises Inc.
Saskatoon, Saskatchewan

Rod Merryweather ^{1/2}
Director of Sales, Canada
Bayer Crop Science,
Calgary, Alberta

Richard Stegmann ³
Chairman
Lange-Stegmann Co.
St. Louis, Missouri USA

Rodney Wiens ³
Farmer
Herschel, Saskatchewan

Greg Yuel ¹
Vice President and COO
PIC Investment Group Inc.
Saskatoon, Saskatchewan

HEAD OFFICE

3935 Thatcher Avenue
Saskatoon, Saskatchewan
Canada S7R 1A3

OFFICERS

John Cross
Chairman

Calvin Sonntag
President / CEO

David Cortens
Chief Financial Officer
and Corporate Secretary

Sanford Gleddie
Vice President
Research and Business Development

Trevor Thiessen
Vice President
Commercial Operations

AUDITORS

Deloitte & Touche LLP
Saskatoon, Saskatchewan

BANKERS

TD Canada Trust
Saskatoon, Saskatchewan

SOLICITORS

McDougall Gauley
Saskatoon, Saskatchewan

REGISTRAR AND TRANSFER AGENT

CIBC Mellon Trust Company
Calgary, Alberta

1 Audit Committee

2 Compensation Committee

3 Corporate Governance Committee

Thank You

Thank you to our customers for their input, retailers and distributors for their business and we are humbled by the fact that our customers increasingly place their trust in our products. We keep re-investing in our products to bring our customers new technologies and features that are in theirs.

Thank you to the service and support people that make our business possible. From the people that get it right to what business we do, they are the heart of how we do business.

Thank you to the people that make our contribution to their lives and to the world. As a company, we are lucky to have the talent and employees that make to the products that we sell. Our contribution is through people that are passionate about their organizations and the world. We are proud to be through our employees and the world including KEO, the people that make our products and the people that make our products. We are proud to be through our employees and the world including KEO, the people that make our products and the people that make our products.

Philom Bios Inc.

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